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Ukraine's credit rating: underestimated or objective?

Ukraine's foreign borrowings could be cheaper for the budget if its sovereign rating, which is currently rather low, was upgraded. While the economic successes of the state are convincing enough for analysts of the leading rating agencies, they blame their low rating of Ukraine on the political factor. For its part, the Ukrainian government considers the significance of this factor to be overestimated, since once in office no political force in Ukraine will revise the policy of state debt repayment. Attendees from the Ukrainian financial sector and journalists had a chance to listen to the arguments of both sides at an international conference involving representatives of the leading international agency Moody's Investors Service and Ukrainian government officials, headed by the Minister of Finance, First Deputy Prime Minister Mykola Azarov

The Ukrainian government often applies for loans to world financial markets, while their players, in turn, exhibit interest in bonds issued by the Ukrainian government. Accordingly, for example, during the last placement of ten-year eurobonds, the Ministry of Finance reported that demand exceeded supply by almost six times. Still, the placement cannot be regarded as fully successful; leading rating agencies, whose assessments are heeded by investors worldwide, classify the obligations of the Ukrainian government as speculative or risky bonds, that is, ones with a high probability of overdue payouts of interest or principal. Meanwhile, the government believes that Ukraine by all criteria deserves a rating upgrade to the investment grade, which would allow it to obtain loans at lower interest.

What is behind Moody's prudent assessments?

The opinion of the Moody's agency was presented by Jonathan Schiffer, Vice President of Moody's Investors Service Ltd. and a lead analyst in the sovereign rating of CEE and CIS countries. He emphasised that when determining a government's credit rating, Moody's gives a very general assessment of two categories: the government's ability and its committment to repay the debts. Primarily, analysts focus on analysis of the government's solvency, which is facilitated by a host of indicators used to measure this ability. But no less attention is paid to the government's willingness to repay its debts, which is defined in a broader sense: "If in the next 6–8 months a crisis breaks out, are the government experts who approve economic decisions qualified enough to foresee the crisis, and are they able to apply government policy (even an unpopular one) that could avert the crisis?"

In terms of ability to repay debts, the following key spheres are looked at:

- balance of payments: a country whose imports regularly exceed exports will not possess enough currency to repay its debts;
- budget: if the state budget expenditures surpass revenues, the country will have a deficit that may translate into new debts;
- state debt: analysis of the already accumulated state debts enables to assess the possibility of servicing future obligations, both domestic and foreign, in the short and long term.

The abovementioned three components constitute the first level of assessment. The second level scrutinises the political situation. Since within a span of 3–5 years every country goes through political changes concomitant with elections, it is necessary to have a clear picture of the level of political stability in the country, what forces are likely to come to power in future, and how this can affect government policy, particularly with regard to the basic analytical components: balance of payments, budget, and state debt.

Moody's seminar for Ukrainian specialists

On 11 December 2003, for the first time in Ukraine, a training seminar was held on "Ratings as Indicators of Credit Risk in Today's Banking: Moody's Methodology for Corporate Clients and Banks", hosted by the International Centre for Policy Studies. Speakers were from Moody's KMV, a company of the Moody's Investors Service Ltd. network specialising in training programs—Alistair Graham, Senior Vice President, and Jesus Fernandez-Munos, Training Manager.

Seminar participants were from 30 Ukrainian government, banking, and insurance structures, investment companies, and domestic rating agencies. The training participants studied the methodology for risk assessment and agency ratings interpretation, obtained advice as regards rating the obligations of Ukrainian business structures, and discussed the status of risk assessment in Ukraine and the prospects for international raters working in the country.

The training elicited an extraordinary interest among Ukrainian business structures planning to enter international capital markets. After all, the gradual upgrade of Ukraine's credit rating, and an increased number of bank issuers willing to have their obligations assessed, have made qualified risk assessment in Ukraine an increasingly important issue.

Government considers the political factor to be exaggerated

Ukrainian Finance Minister Azarov believes that there are neither economic nor political reasons for being prudent about the credit rating of the Ukrainian government. Mr. Azarov noted that in Ukraine's political spectrum there is no real contender for office who would adopt an unbalanced budget policy, refuse to repay foreign and national loans, seriously reconsider privatisation results, or abandon the policy of structural reforms. Ukraine has a low state debt-to-GDP ratio, a stable balance of payments, rising foreign direct investment inflows, and timely fulfilment of its debt obligations, regardless of the not infrequent changes of government. Therefore, Mr. Azarov believes that by all criteria Ukraine belongs to the investment grade on the rating scale. Notably, in autumn 2003 Russia was granted the investment grade by Moody's.

Low rating costs Ukraine 150 million USD annually

The higher the rating, the stronger the confidence of institutional investors in the government, and the lower the interest the government can offer investors for money borrowed. Hundreds of millions of dollars are at stake. Ukrainian euro bonds are rated B1 in the Moody's chart. Today, this puts its national bonds at 350 basis points lower than the rate of return on US Treasury bonds, which are the stability standard in the financial market. If Ukraine's rating was upgraded to the investment grade (Baa3), its foreign debt payments would shrink by 150 million USD annually.

ICPS economists believe that in the years to come, Ukraine will be participating in the eurobond market more and more often. Already in 2004, the country will issue new bonds worth up to 1.5 billion USD (up from 1 billion USD in 2003), with specialists expecting the loan rate to drop from 7.65% to 6–6.5% per annum. ICPS considers rating agencies to be generally conservative institutions, taking a long time to weigh all the pros and cons of changes in ratings. Often, corrected ratings for Ukraine are announced a month after the mission of a particular agency has been completed in the country. The recent regular visits of rating agency experts to Ukraine demonstrate a high level of interest in Ukrainian bank issuers in the world market. In the current favourable economic conditions, this will translate into a gradual upgrade of ratings by all three of the leading agencies—Moody's, Standard&Poor's, and Fitch.

Role of raters in the financial market

Agencies are a link between borrowers and creditors. On the one hand, there are those who want to borrow money—governments and companies—while on the other, there are the institutional investors—banks and pension funds—who want to effectively place their money. To this end, they need information about borrowers' ability to deliver on their obligations.

Despite the fact that numerous ratings of countries and companies are generated by practically all banks' analytical departments and other institutional investors, such ratings are generally held in lower confidence, since their authors are interested in obtaining profit from their research targets. Credit agencies are considered to be more independent, since they neither make their own investments nor issue securities, nor purchase the stocks of the companies they rate.

What is the Moody's rating scale?

The rating scale of long-term debt obligations starts from the highest rating, "Aaa", and descends to the lowest rating, a "C". The scale is divided into 21 grades and is considered in terms of two grades, investment and risky.

Investment class

Aaa — first-grade securities

Aa1, Aa2, Aa3 — high-grade securities

A1, A2, A3 — above medium category

Baa1, Baa2, Baa3 — medium category

Risky grade

Ba1, Ba2, Ba3 — generally a risky category

B1, B2, B3 — securities that are unattractive for investment

Caa1, Caa2, Caa3 — bonds with an unfavourable reputation

Ca — the riskiest securities

C — the lowest rating; securities with wholly unattractive investment prospects.

Short-term (less than a year) debt obligations are rated as follows: Prime-1 (highest category), Prime-2, Prime-3, Not Prime (could be considered as risky grade).■

The international conference "Risk Management and Credit Ratings in Ukraine" took place on 12 December 2003. It was organised by the National Bank of Ukraine, the International Centre for Policy Studies, and the Kredyt Reitynh National Rating Agency. For further information, please contact Andrew Blinov at tel.: +380-44-236-1292 or e-mail to ablinov@icps.kiev.ua.

Ukraine's Sovereign Ratings

Agency	Rating	Forecast
Standard&Poor's	Issuer Credit Rating — **B**	Positive
Moody's Investors Service	Long-term bonds and notes — **B1** Long-term bank deposits — **B2**	Stable
Fitch	Long-term foreign and local currency — **B+** Short-term foreign currency — **B**	Stable
Rating&Investment Information Inc. (R&I)	Long-term foreign currency — **B+**	Stable

ICPS annual report presented at the Supervisory Board meeting

A regular meeting of the Supervisory Board took place on 13 December 2003, during which ICPS presented its annual financial and activity reports.

The following key achievements in 2003 were mentioned:

- research on current government policy issues (in particular, the impact of EU enlargement on Ukraine's foreign policy);
- expanded cooperation with ministries and other government bodies with regard to the implementation of European Union standards;
- launch of new publications ***political commentary*** and ***regional trends***;
- ICPS's role as a resource centre, sharing its policy analysis experience within Ukraine and with Central Asian countries;
- close cooperation with think tanks of the Open Society Institute network, and joint execution of international projects.

Next year—the year of the presidential election in Ukraine—ICPS will channel its efforts to boost the quality of public policy in Ukraine by putting priority reform tasks on the agenda of public debates. To this end, two projects—"Public Opinion on Government Priorities" and "Public Participation in the Dialogue on Party Platforms"—were aimed at involving the Ukrainian public in policymaking.

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To be included in the distribution list, please contact the ICPS publications department at marketing@icps.kiev.ua
icps newsletter editor Yevhen Shulha (shulha@icps.kiev.ua). Phone: +380-44-236-4477.
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